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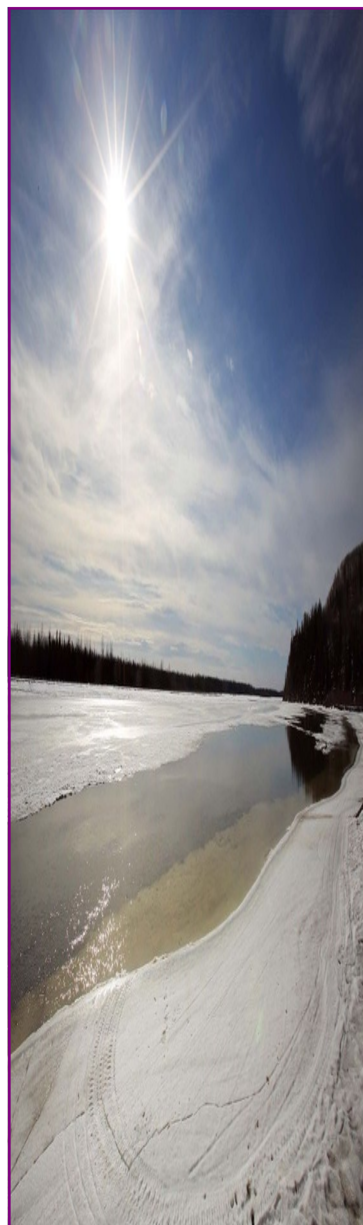
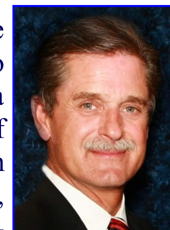
OLIVE SEZ— NOTTHISTIME



Spring is here! Courtesy of the Fairbanks Daily Newsminer

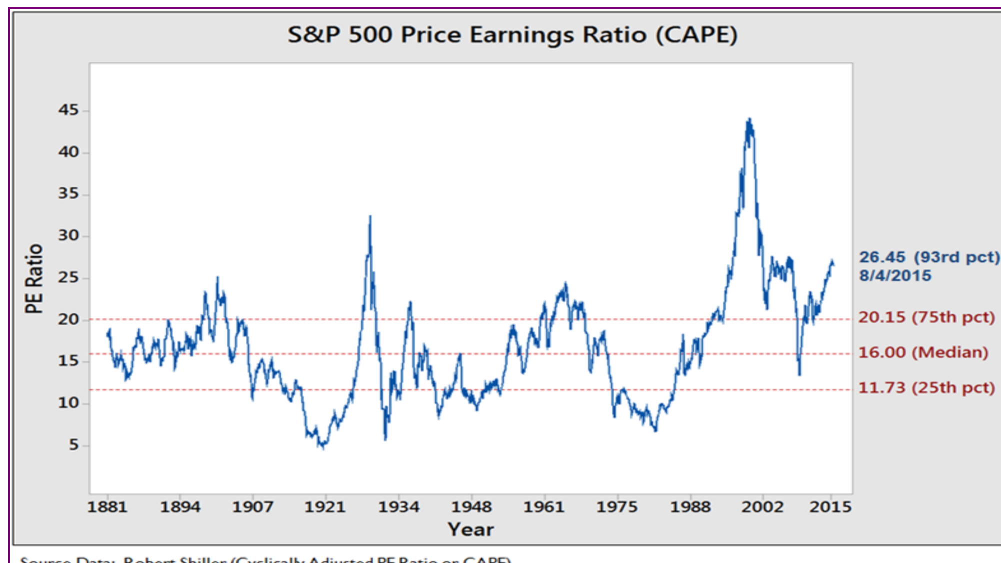
Scott's Thoughts —



Scott Husband

During the first 5 years I entered the investment business, the average price to earnings ratio on the S&P500 was 8.6. It took $8.64 cents to purchase a dollar of earnings. January 1, 1987, required $18.01 to buy a dollar of income. The market rose and dropped by a third in the fall of that year. Near the peak of the Dot.com craze, on January 1, 2000, an investor needed $29.04 to buy a dollar of S&P500 earnings. Of course, all the excitement was in the Nasdaq 100 which traded even more expensive and began a 3 year decline of 80%. Today the S&P500 is trading for 22.86 times earnings, which is not a record high, but about a third higher than the longer term average and about 3 times more expensive than when I entered the business.

Robert Schiller brought forth a slightly different method of viewing the market's value by formulating the "cyclically adjusting P/E ratio" (CAPE). The chart below shows the "CAPE" over the past 130 years. Ninety three per-cent of the time stocks have sold for less and on the few occasions they traded this high, if stocks were not sold, cash eventually out-performed.



Source Data: Robert Shiller (Cyclically Adjusted PE Ratio or CAPE).

The price earnings ratio is but a single, though important, measure of stock market value. Price to sales is another method. This ratio is nothing more than the title suggests. Since December of 2000, the ratio has traded within the range of .87 (December 2008, Great recession days) and 1.82 (current). The current **median** price to sells ratio is higher than at the peak of the Dot.com era and higher than at the moment just prior to the start of the Great Recession. The sells per share (it too, is simply what the title implies) is around $283, which is as high as the last 16 years offers. There are ratios that do not imply the stock market is expensive, though I am not aware of any that suggest the stock market is inexpensive. As examples, dividend yield is not extraordinary, but with overall interest rates near zero, that would be expected and the price to book is within normal boundaries. There are many methods of evaluating a market's relative value and the majority suggest investors will have an opportunity to purchase good companies at a better price in the future.

Scott's Thoughts (continued)

There is little that needs to be said regarding interest rates. Today's pundits argue about a possible decline of 1% in the long bond rate. The current rate is about 2.5%. A rise of 1/10th of 1% in yield takes an entire year's income away (the bond price declines by 2.5%). A move to 3.5% (still a few points lower than normal) eliminates a quarter of the bond's value. Remember, at the height of the interest rate move of 1980, a AAA Tax Free bond paid 15% as did the 30 year treasury. I have chosen to forgo perhaps ¾% greater yearly income for the assurance of substantial and predictable near term return of principal. Does anyone really believe it makes sense to buy a bond with rates this low? The buyer may look good for a while longer, but ultimately I find it a near certainty that this extraordinary experiment with low to negative interest rates will end very badly. I simply cannot imagine that human history has all been wrong up to the Great Recession and that it is fine, appropriate, and logical to pay someone to hold your savings (negative interest rates). It's a question of only "when" today's "new normal" becomes the topic we all say we knew could not last (like "this time was different" in the Dot.com days and housing appreciating 30% a year leading up to the Great recession and even expecting shorter term interest rates to increase beyond 24% in 1980).

Every market cycle has its own individual characteristics. There certainly is no particular alarm that tells us when the time is right to change course. Those that have done well have chosen to stay invested in this expensive market. Perhaps 2016 will not be the year the stock and bond markets begin their decline to what generations in front of us have found to be prudent valuations. However, history is screaming beware.

The first quarter of 2016 brought us a quick and hurtful stock market decline which was reversed after another "dovish" statement from the Central Bank. Ironic as it is, a central bank leaving rates low is an admission of a weak economy, which makes stocks move higher (?). We have had four quarters of declining earnings for the S&P500, with a 5th expected. Revenues are declining. Corporate buy backs have slowed but not stopped (keep in mind that buy backs have been credited as the primary cause of the large advance in equity prices). Unemployment is officially lower than 5%, but only because so many have stopped looking for work (if one stops looking one is no longer counted as unemployed). Record low labor participation rates support the argument. The transportation stocks are still way down (typically an indicator of future market direction), Europe is heading towards a recession and perhaps greater social unrest, the US may already be in a recession, and the list does go on. The news is so bad that I would expect the stock market to be near lows. However, and I believe this is the primary reason for the extreme valuations placed on investment assets today, money is abundant, extremely abundant. As I mentioned earlier, there is so much money we now have to pay someone to hold it for us. Enough said.

The quarter's best performing asset was gold. The third best performing asset was silver. There are four asset classes: stocks, bonds, real estate, and things you can hold in your hand. Three of those are at or near record highs. And the companies that produce this quarter's best performing asset were at forever record lows. In the long term, we should be under-exposed to expensive and over-exposed to cheap. Sounds like the successful investing formula: "buy low, sell high".